

# **Transforming Department of Defense Financial Management**



## **A Strategy for Change**

**Final Report**

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## Executive Summary

At the request of the Secretary of Defense (SECDEF), the Department of Defense (DoD) contracted with the Institute for Defense Analyses to conduct a study to recommend a strategy for financial management improvements within the Department. **The Study Group envisions a future in which relevant, reliable and timely financial information<sup>1</sup>, affirmed by a clean audit opinion, is available on a routine basis to support management decision-making at all levels throughout DoD.** Relevant financial information will tell managers the costs of forces or activities that they manage and the relationship of funding levels to output, capability or performance of those forces or activities. Reliable financial information will provide a more accurate basis for decision-making and be affirmed by a clean audit opinion. Such financial information will be available to managers at all pertinent levels, from those charged with carrying out DoD's missions at the theater and national levels down to the managers of supporting activities.

Current DoD financial, accounting and feeder/operational management systems do not provide information that could be characterized as relevant, reliable and timely. Nor is the "support of management decision-making" generally an objective of the financially based information currently developed or planned for future development. Front-end investment and much work need to be done to accomplish a necessary transformation. Many positive projects are currently underway in DoD; however, they are narrowly focused, do not have sufficient senior leadership and urgency behind them, and are not part of an integrated DoD-wide strategy.

## Vision

Financial management in DoD should be focused on a single objective: Delivering relevant, reliable and timely financial information on a routine basis to support management decisions. Appropriate focus on improved financial information will markedly improve the opportunities to:

- **Provide visibility to cost incurred** which is a critical underpinning of efficiency improvement;
- **Institutionalize the use of performance metrics that are tied to cost** and relevant to the mission of DoD in the management process of the Department. This is a process that is key to establishing benchmarking standards and raising the level of performance;
- **Identify and take action, on an on-going basis, on performance improvement** (cost and effectiveness), **including private sector partnering** as appropriate;

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<sup>1</sup> For purposes of this report, financial information includes: accounting records and reports; financial records and reports; cost-based performance metrics related to mission; and budget and appropriation data.

- **Ensure clean audits and routine compliance with Federal financial standards** and related accounting and financial regulations; and
- **Increase the credibility of DoD's financially based information** with Congress, the Office of Management and Budget (OMB) and other oversight agencies that have critical input into DoD operations.

## **Current Situation**

Many studies and interviews with current and former leaders in DoD point to the same problems and frustrations. Repetitive audit reports verify the systemic problems; while they indicate some improvement, they illustrate the need for radical transformation in order to achieve real progress. As a result, DoD has developed a credibility problem with Congress, OMB, the General Accounting Office (GAO) and itself, when it comes to financial information. **Situations and problems associated with the current DoD environment include:**

- Inability to consistently provide reliable financial and managerial data for effective decision-making;
- Lack of an overarching approach to financial management – disparate systems (accounting, financial and feeder) hampered by lack of integration and standardization;
- Overly complex data requirements driven by appropriation funding rules, elaborate policies and procedures, and outdated guidelines for excessively detailed tracking of expenditures;
- “Convoluting” business processes which fail to streamline excessive process steps – sometimes driven by accounting, operational, and organizational structures, further complicated by aged and disparate systems;
- Changing federal financial management standards that have provided a moving target for compliance;
- Difficulty in obtaining financially based, outcome-oriented management metrics. Many metrics reflect yearly goals and outputs with little link between financial management and DoD Goals;
- Inability to produce Chief Financial Officer (CFO) Act compliant annual financial statements;
- Disproportionate budget dollars appear to support non-value added activities – since useful information is hard to extract, useful corrective action is difficult to implement – with a lack of wide-spread understanding of how financial information can help;
- Cultural bias toward status quo – driven by disincentives for change, and short timeframes of political appointees who otherwise might serve as agents of change; and
- Requires an infusion of personnel with technical and financial skill sets necessary to achieve integrated financial management systems.

To date, DoD’s efforts to improve financial information have focused primarily on obtaining reliable information, and a protracted effort involving people, systems and data

still is required to reach the goal. But it is possible to reach the goal of reliable financial information and a clean audit opinion and still not have information that is relevant to managers. A complementary effort is needed to ensure that DoD's management information systems also provide relevant information. This includes selecting performance metrics, linking them to costs and institutionalizing their use in management and decision-making.

## Elements of Transformation

Past studies have given significant attention to such matters as: achievable cost savings, productivity improvements, private sector partnering and other operating efficiencies. While useful projects are being carried out, few of the recommendations contained in these reports (reference *Appendix A, Current Situation Examples, Figure A-1*, for selected recent studies) have been implemented on a wide-scale basis. **We believe that the absence of relevant, reliable and timely financial information (“financial intelligence”) and the need for an accelerated pace and a more assured outcome in improving DoD efficiency are related.** Each can be traced to similar origins within DoD's operating fabric.

**Accordingly, we recommend an integrated twin-track program to implement a financial transformation.** It includes six broad elements that we believe are central to substantially improving the financial management within DoD and providing a foundation for change. These **Elements of Transformation** are:

1. **Leadership** – establishing a SECDEF and senior leadership high priority for financial information transformation;
2. **Incentives** – addressing the current disincentives within DoD for engaging in financial reform;
3. **Accountability** – establishing a transformation framework with clear measurements, timeframes and assigned personal responsibilities and authority;
4. **Organizational Alignment** – SECDEF empowerment of the DoD Comptroller to act as the focal point for implementing an integrated DoD-wide program for financial management transformation;
5. **Changing Certain Rules** – directly addressing with Congress and OMB regulations and legal issues that hinder innovation and private sector partnering; and
6. **Changing Enterprise Practices** – modifying current overemphasis on Component process “uniqueness” that hinders forward progress, by standardization of core accounting requirements<sup>2</sup> and establishing a bias towards commercial off-the-shelf software (COTS) systems.

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<sup>2</sup> Standardization of “core accounting” is intended to include only a subset of data (standard general ledger transaction level accounting events and data elements for reporting) required for DoD financial information management and does not include genuinely unique military data requirements.

## Financial Transformation Framework

A program is needed that will incorporate the elements described above and provide for a functional and technical architecture for achieving integrated financial and accounting systems in order to generate relevant, reliable and timely information on a routine basis and, ultimately for obtaining a clean opinion. **The Study Group recommends a framework for a twin-track program for financial information transformation.** The recommended framework would not only take advantage of certain on-going improvement actions within the DoD but also provide specific direction for a more coordinated, managed and results-oriented approach. The recommended framework includes:

### Track 1 –Structural Change

**Employ a coordinated DoD-wide management approach to developing standard integrated systems**, obtaining relevant, reliable and timely financial intelligence (and ultimately a clean audit opinion) and aligning, incentivizing and authorizing the Department to utilize financial intelligence in an efficient and effective way.

Structural Change (Track 1) will require a longer timeframe and will include establishing a centralized oversight process under the Comptroller for implementing the recommended structural changes and developing standard, integrated financial intelligence systems. A phased approach should be taken which will allow for important incremental success yearly (e.g., with defined systems architecture and incremental improvements).

### Track 2 – Close-in Success

**Target, select and oversee implementation of a limited number of intra-Service/cross-Service projects for major cost savings or other high-value benefit under a process led by the Comptroller; assist the SECDEF in establishing and managing with a set of “Dashboard Metrics”.** Dashboard metrics should be derived from the SECDEF’s Critical Success Factors. **Track 2 should be used as a learning experience on using financial information to drive decision-making.**

Prime tools of such improvements would include activity based costing (ABC) and benchmarking/best practices analysis to identify cost savings opportunities. A series of key management metrics will be identified, tracked and reported to those with senior managerial responsibility, including mission related-departments.

(During our interview process, logistics throughout DoD was mentioned numerous times as an area where progress has been made in recent years, but opportunities still exist for high-value improvements. While our timeframe did not allow us the opportunity to analyze the costs and benefits of this particular reengineering prospect, it deserves active consideration by the proposed Management Initiatives Office described below.)

**Critical to the success of both tracks of the recommended program is the establishment within the OUSD(C) of two new functions represented by distinct offices.** Through these two offices – the Financial and Management Information Integration Office and the Management Initiatives Office – the Comptroller would provide executive control over processes, policies and resources for financial management and related systems transformation. Current structure does not provide for an authoritative focal point for DoD-wide financial management transformation. Lean but full-time staffing is essential to the success of both offices. At the Comptroller's discretion, these two organizations could be created with some newly recruited talents as well as existing DoD staff; they are intended to fill a void as discussed above, not to duplicate or create additional layers. These two offices would (working with the Components) develop options for approval, monitor progress and regularly report to the SECDEF on progress, problems, and possible solutions. They would control resources for financial management, systems transformation (although the Components would manage such programs), and take a leadership role in developing incentives. Each function must be headed by an individual who has sufficient stature and empowerment to act as an effective change agent. Led by the Comptroller, the heads of these two offices should reach out to the Services and DFAS, as well as Congress, to coordinate the development of a strategy and effective implementation. Each office is described below:

**Financial & Management Information Integration Office** – accountable for effective implementation and coordination of overall financial and related systems architecture [in consultation with the Services, the Assistant Secretary of Defense for Command, Control, Communications and Intelligence (ASD(C3I)) and others], systems integration, core accounting standardization and CFO compliance issues on an intra- and cross-Service basis; develop a phased plan for progressively increasing the number of individual statements on which a clean audit opinion can be obtained; and over time, institutionalize in DoD's financial management information systems the ability to routinely generate the Dashboard Metrics established by the Management Initiatives Offices and DoD senior leadership.

**Management Initiatives Office** – responsible for the process of establishing and initially reporting on Dashboard Metrics; and on an intra- and cross-Service basis, work with the DoD Components to select projects for major cost and operational improvements, providing initial funding for a limited number of projects per year and overseeing implementation with use of consultants and private sector partnering, as appropriate.

**The path to full transformation is a long one. We recognize that the complete solution is key to ensuring that the transformation has a permanent impact on DoD operating policies; however, important nearer term improvements in operating efficiency and effectiveness can be achieved.** The recommended twin track approach allows for near-term successes while working towards the longer-term objective of delivering relevant, reliable and timely financial information.



## Significant Challenges

We believe the most difficult challenges to be addressed in implementing our recommended program are:

- Developing an integrated system architecture including financial, accounting and feeder systems;
- Standardizing a DoD-wide “core” accounting and data classification;
- Engaging Congress and OMB to ameliorate certain rules: simplify record keeping and accounting requirements, remove impediments to a more efficient infrastructure management, and reduce hurdles to private sector partnering;
- Providing DoD management, including the Commanders in Chief (CINCs), with enhanced financial intelligence, incentives and tools; and encouraging them to maximize the efficiencies and effectiveness of their operations and suppliers; and
- Imbuing the culture with a sense of urgency for a DoD-wide financial management information transformation, similar to Y2K.

## Catalyst for Change

The catalyst for effectively implementing these recommendations will be the leadership provided by the SECDEF and his senior management team. A vision for financial information, such as that described herein, has been accomplished in the private sector on a widespread basis, through the development of financial intelligence and the reporting, analysis and measurement of business process reengineering results, using such intelligence. Our interviews and discussions with senior representatives of DoD, both current and past, lead us to believe that the organization is ripe for this financial management leadership change. The DoD needs better financial information if it is to follow Deputy Secretary of Defense Wolfowitz's admonition "to engage our brains before we open the taxpayer's wallet". This proposed transformation program will provide the needed leadership, accountability and structure to re-engineer financial management within DoD.

*“That which you require be reported on to you will improve, if you are selective. How you fashion your reporting system announces your priorities and sets the institution’s priorities.”*

Rumsfeld’s Rules

Track 1 – Structural Change Recommended Implementation Actions		Responsibility
Leadership	SECDEF Leadership – one of SECDEF's and senior leaderships' highest priorities  Establish, empower and fund the Financial and Management Information Integration Office – reporting to USD(C)	SECDEF – Sr Leadership  SECDEF/OUSD(C)
Incentives	Create DoD-wide awareness and reward system in support of increased efficiency and improved productivity – money saver keeps a portion of savings within his/her organization for high value added purposes  Work (with Congress as required) to change the Personnel recognition and reward system to reinforce achievement in this financial information transformation initiative	SECDEF – Sr Leadership  SECDEF
Accountability	Institutionalizing in DoD's financial management information systems the ability to routinely generate the Dashboard metrics established by the Management Initiatives Office and DoD senior leadership	SECDEF – Sr Leadership; OUSD(C)



	<b>Track 1 – Structural Change Recommended Implementation Actions</b>	<b>Responsibility</b>
<b>Changing Certain Rules</b>	<p>Seek increased flexibility from Congress, OMB, Office of Personnel Management (OPM) and others to:</p> <ul style="list-style-type: none"> <li>▪ Reallocate and reinvest saved dollars</li> <li>▪ Remove outmoded impediments to a more efficient infrastructure               <ul style="list-style-type: none"> <li>– Simplify appropriations accounting requirements</li> <li>– Establish a cost-benefit analysis process for dealing with low value write-offs (e.g., unmatched disbursements below a minimum threshold, including elimination of accounting for cancelled accounts)</li> <li>– Consider "sunsetting" burdensome past mandates of reporting requirements</li> </ul> </li> <li>▪ Utilize more commercial practices in the process for private sector partnering</li> <li>▪ Negotiate a phased approach to achieving a clean audit opinion (e.g., can start with Statement of Budgetary Resources)</li> <li>▪ Seek authorization to break pay grades to hire and retain financial and technology talent (use IRS as example)</li> <li>▪ Personnel initiatives               <ul style="list-style-type: none"> <li>– Capitalize on looming large scale retirements as an opportunity to upgrade necessary skill sets</li> <li>– Enable DoD to match capabilities to needs rather than retention of staff by longevity (i.e., achieve rightsizing with the needed skill sets)</li> <li>– Establish personnel incentives related to achieving increased organization efficiency</li> </ul> </li> </ul>	SECDEF – Sr Leadership



Track 2 – Close-in Successes Recommended Implementation Actions		Responsibility
Leadership	SECDEF Leadership – one of SECDEF's and senior leaderships' highest priorities Establish, empower and fund the Management Initiatives Office – reporting to USD(C)	SECDEF – Sr Leadership SECDEF/OUSD(C)
Incentives	Create DoD-wide awareness and reward system in support of increased efficiency and improved productivity – money saver keeps a portion of savings within his/her organization for high value added purposes Work (with Congress as required) to change the personnel recognition and reward system to reinforce importance of close-in actions	SECDEF – Sr Leadership SECDEF – Sr Leadership
Accountability	Identify and institutionalize SECDEF Critical Success Factors and Dashboard Metrics SECDEF's senior subordinates establish more granular Critical Success Factors and related metrics to achieve SECEF priorities Integrate metrics into the management of DoD, monitor and regularly report on performance to SECDEF and senior leadership Benchmark to similar private industry operations	SECDEF – Sr Leadership; SECDEF – Sr Leadership SECDEF – Sr Leadership OUSD(C)

	<b>Track 2 – Close-in Successes</b> <b>Recommended Implementation Actions</b>	<b>Responsibility</b>
<b>Organizational Alignment</b>	<p>Emphasize Comptroller (CFO) leadership role in transformation program:</p> <ul style="list-style-type: none"> <li>▪ Use outside consultants as necessary</li> <li>▪ Provide regular briefings to SECDEF on progress, at least every 30 days</li> <li>▪ Provide initial funding for a limited number of projects each year</li> </ul>	SECDEF/OUUSD(C)
<b>Changing Rules</b>	<p>Work with Congress and OMB to facilitate close-in cost and effectiveness improvement programs (e.g., enable more private sector partnering in processes that are inherently commercial)</p>	SECDEF – Sr Leadership
<b>Changing Enterprise Practices</b>	<p>Develop and implement close-in major cost and efficiency improvement programs</p> <ul style="list-style-type: none"> <li>▪ Utilize cost management tools (e.g., Activity Based Costing and Management)</li> <li>▪ Select a limited set of intra-Service and cross-Service cost and/or process improvement targets of opportunity (e.g., consider DoD-wide logistics)</li> <li>▪ Benchmarking/best practices</li> <li>▪ Expand and continue successful efforts</li> </ul>	OUUSD(C)

## 1.0 Introduction

The Department of Defense (DoD) is challenged by an inferior financial management information systems infrastructure. **Large, complex U.S. companies are able to leverage technology to streamline processes and integrate sophisticated personnel and logistics systems with their financial systems. However, the DoD finds itself hampered with a financial management structure that is in large part aged.** Beyond the multiplicity of disparate financial management systems throughout each of the Components, the information systems infrastructure is further hampered by the lack of functional and technical integration<sup>3</sup>.

Many studies and interviews with current and former leaders in DoD point to the same problems and frustrations. **Repetitive audit reports verify the systemic problems; while they indicate some improvement, they illustrate the need for radical transformation in order to achieve real progress.** As a result, DoD has developed a credibility problem with Congress, the Office of Management and Budget (OMB), the General Accounting Office (GAO) and itself, when it comes to financial information.

Further, past studies have given significant attention to such matters as: achievable cost savings, productivity improvements, private sector partnering and other operating efficiencies. While useful projects are being carried out, few of the recommendations contained in these reports (reference *Appendix A, Current Situation Examples, Figure A-1* for selected recent studies) have been implemented on a wide-scale basis. **We believe that the absence of relevant, reliable and timely financial information (“financial intelligence”) and the need for an accelerated pace and a more assured outcome in improving DoD efficiency are related.** Each can be traced to similar origins within DoD’s operating fabric.

**The systemic problems addressed in this report are not strictly “financial management” problems and cannot be solved by the financial community alone. The solution will require the concerted effort and cooperation of cross-functional communities throughout the Department.**

At Secretary Rumsfeld's request, DoD contracted with the Institute for Defense Analyses (IDA) to address financial management transformation. Specifically, the IDA Study Group, comprised of experienced business people, supported by a private sector professional services firm under separate contract, was **tasked to develop the framework for an effective transformation of financial management throughout the DoD.**

This report was developed based on multiple sources of information – relevant reports and studies on the DoD and an interview process that generated past and present senior leader perspectives throughout DoD and other key governmental agencies.

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<sup>3</sup> Integration throughout this document is intended to imply both functional (definitional) standardization and technical compatibility in order that systems are interoperable. It is not intended to imply standardized business processes.



## 2.0 Vision

**The Study Group envisions a future in which relevant, reliable and timely financial information<sup>4</sup>, affirmed by a clean audit opinion, is available on a routine basis to support management decision-making at all levels throughout DoD.** Relevant financial information will tell managers the costs of forces or activities that they manage and the relationship of funding levels to output, capability, or performance of those forces or activities. Reliable financial information will provide a more accurate basis for decision-making and be affirmed by a clean audit opinion. Such financial information will be available to managers at all pertinent levels, from those charged with carrying out DoD's missions at the theater and national levels down to the managers of supporting activities.

Current DoD financial, accounting and feeder/operational management systems do not provide information that could be characterized as relevant, reliable and timely. Nor is the "support of management decision-making" generally an objective of the financially based information currently developed or planned for future development. Front-end investment and much work need to be done to accomplish a necessary transformation. **Many positive projects are currently underway in DoD; however, they are narrowly focused, do not have sufficient senior leadership and urgency behind them, and are not part of an integrated DoD-wide strategy.**

Financial management in DoD should be focused on a single objective: Delivering relevant, reliable and timely financial information on a routine basis to support management decisions. **Appropriate focus on improved financial information will markedly improve the opportunities to:**

- **Provide visibility to cost incurred** which is a critical underpinning of efficiency improvement;
- **Institutionalize the use of performance metrics that are tied to cost** and relevant to the mission of DoD in the management process of the Department. This is a process that is key to establishing benchmarking standards and raising the level of performance;
- **Identify and take action, on an on-going basis, on performance improvement** (cost and effectiveness), **including private sector partnering** as appropriate;
- **Ensure clean audits and routine compliance with Federal financial standards** and related accounting and financial regulations; and
- **Increase the credibility of DoD's financially based information** with Congress, OMB, and other oversight agencies that have critical input into DoD operations.

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<sup>4</sup> For purposes of this report, financial information includes: accounting records and reports; financial records and reports; cost-based performance metrics related to mission; and budget and appropriation data.

### 3.0 Current Situation

More than ten years ago, the U.S. Congress passed the Chief Financial Officers (CFO) Act, mandating that the Federal agencies prepare annually a set of auditable financial statements detailing assets and liabilities and the results of their annual operations. Selected agencies, including parts of DoD, were included as pilots for this program. In 1994, Congress passed the Government Management and Results Act, mandating that the CFO Act applies to all agencies. For FY 2000, DoD, once again, was unable to meet the requirements of the CFO Act. Even more troublesome is the awareness that compliance with the CFO Act remains out of reach, far over the horizon.

In the current environment, DoD has a serious credibility problem in financial management. On January 11, 2001, in the confirmation hearing of the Secretary of Defense (SECDEF), Senator Byrd questioned the Defense Department's inability "to receive a clean audit opinion in its financial statements". He went on to say, "I seriously question an increase in the Pentagon's budget in the face of the department's recent (inspector general) report. How can we seriously consider a \$50 billion increase in the Defense Department's budget when the (Department of Defense's) own auditors--when DoD's own auditors--say the department cannot account for \$2.3 trillion in transactions..."

In subsequent Senate testimony of February 13, 2001, Senator Grassley referenced these questions and continued, "...these reports show that DoD has lost control of the money at the transaction level. With no control at the transaction level, it is physically impossible to roll up the numbers into a top-line financial statement that can stand up to scrutiny and, most importantly, audit."

While DoD may debate some of the criticisms of its financial statements and the size and components of the \$2.3 trillion issue, we think that corrective action requires radical financial management transformation. For the FY 1999 financial statements, the auditors concluded that \$2.3 trillion transactions of the \$7.6 trillion entries to the financial statements were "unsupported". DoD notes that many of these entries included end-of-period estimates for such items as military pension actuarial liabilities and contingent liabilities, and manual entries for such items as contract accounts payable and property and equipment values. DoD would further note that the "unsupported" entries are "not necessarily improper" and that documentation does exist in many cases, albeit, not adequate for the auditing standards imposed.

To date, DoD's efforts to improve financial information have focused primarily on obtaining reliable information, and a protracted effort involving people, systems and data still is required to reach the goal. But it is possible to reach the goal of reliable financial information and a clean audit opinion and still not have information that is relevant to managers. A complementary effort is needed to ensure that DoD's management information systems also provide relevant information. This includes selecting performance metrics, linking them to costs, and institutionalizing their use in financial management information systems and management decision-making.

## **Situations and problems associated with the current DoD environment include:**

### **Issue 1 – Inability to consistently provide reliable financial and managerial data for effective decision-making**

DoD cannot produce, on a consistent basis, reliable financial and managerial information to guide effective decision-making. This is reflected in the inability to produce clean financial reports automatically and to generate succinct management cost information consistently on demand. Management must be capable of acting with agility and responding rapidly to opportunities and challenges. When relevant financial information is needed, management cannot always afford to wait days or even weeks for data calls. Further, management cannot operate effectively with frequently unreliable information. Interviewees cited multiple examples of the manual calls for key managerial data and the need for tracking off-line their expenditures on program areas (due to the unreliability and lag time in obtaining data required to manage day-to-day operations).

Much of the financial data used to develop financial statements and provide the basis for management decisions is unreliable. Currently, about 91 critical operating systems feed information to approximately 61 critical accounting systems.<sup>5</sup> Few of these systems speak the same language (charts of account, data elements) and fewer still provide automatic data feeds upstream. Many work-arounds and off-line records are maintained to translate data from one system to another and to feed data up the financial chain. Currently, balance sheet information is not maintained on a widespread scale, resulting in significant manual adjustments in many areas, including property accounts.

### **Issue 2 – Lack of an overarching approach to financial management – disparate systems (accounting, financial and feeder) hampered by lack of integration and standardization**

The current environment is supported by a systems infrastructure that DoD categorizes by primary function – respectively, accounting<sup>6</sup>, finance<sup>7</sup>, and feeder<sup>8</sup> systems. No single authoritative source is currently addressing, from a strategic and programmatic level, the key issues from an *end-to-end approach*. This includes addressing incompatible and technologically-dated systems, and defining and standardizing the financial requirements and managerial data needed for reporting and decision-making.

A void exists in the organizational structure with respect to developing and implementing an overall financial management strategy. Two chains of command within DoD perform

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<sup>5</sup> Source: DoD Financial Management Improvement Plan (FMIP), January 2001

<sup>6</sup> According to the DoD FMIP, 61 critical accounting systems process event transactions for Defense Working Capital Funds, General Funds, Security Assistance, Departmental Reporting, Cash Accountability, and others.

<sup>7</sup> According to the FMIP, 15 critical finance systems process payment transactions for Civilian Pay, Debt Management, Military Pay, Contract/Vendor Pay, Disbursing, Transportation, and Travel.

<sup>8</sup> According to the FMIP, 91 critical feeder systems capture financial management events related to functions such as Acquisition, Personnel, Cost Management, Property Management, and Inventory Management at DoD Component levels.

finance and accounting functions<sup>9</sup>. The Defense Finance and Accounting Service (DFAS), reporting to the Office of the Under Secretary of Defense (Comptroller) [OUSD(C)], is responsible for improving compliance of the General Fund and Working Capital Fund accounting and finance systems and the production of the Service financial statements. The Services, reporting directly up the chain to their respective Secretaries, are responsible for all data in their systems and for improving their feeder systems.

The development of systems is reflective of both the functional and budgetary structure of the Services. Historically, systems were developed within functional areas at the Service level, or even lower levels, as a means to automate existing processes, with little thought given to end-to-end processing. Consolidation and interface development to integrate systems has been a focus of the 1990s. But to a large extent, the relationships among feeder, accounting and financial systems are still “detached” from the perspective of data standardization, transactional standardization, and system compatibility. This detachment causes much re-entry of data, “crosswalking” or matching of data through elaborate edit processes and conversion tables, creating timing delays – all of which contribute to an inability to determine the status of financial information on a routine basis.

Much work has been done with the development of the annual Financial Management Improvement Plan (FMIP), but it is a work in process and, has been cited as being “perpetually out of date”. The FMIP only identifies critical systems for financial reporting and is not intended to include the complete inventory of systems. There appears to be no overarching plan or coordinated planned strategy against which each DFAS and Component initiative is evaluated. Under the guidance of a future-focused plan and strategy, the investments already made under the FMIP would have longer-term benefit.

In January 2001, a Senior Financial Management Oversight Council was established to address CFO compliance. The announcement of this council notes that it was modeled on a similar approach within DoD that successfully addressed the Y2K issue by engaging senior leaders across the organization in a coordinated effort. The Comptroller should review the charter of this new council, its make-up and approach to determine if they are consistent with the financial management transformation framework described later.

### **Issue 3 – Overly complex data requirements driven by appropriation funding rules, elaborate policies and procedures, and outdated guidelines for excessively detailed tracking of expenditures**

Financial, accounting and feeder systems and processes are rife with incredible complexities caused by inconsistent data elements<sup>10</sup>. Due to its complexity,

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<sup>9</sup> Source: DoD FMIP, January 2001

<sup>10</sup> Systems often carry with each transaction upwards of 60 to 100+ populated data fields to identify a transaction according to the internal and external reporting requirements. In general, this is substantially more than the private sector model. Efforts to standardize using the DFAS Budget Accounting Classification Code or Standard Fiscal Code have projected the total number of standardized data elements to exceed 250+. A substantial number of excessive fields severely hamper interoperability.

appropriation funding rules, and a number of disparate systems, DoD has a more complex problem than civilian agencies. Attempts to streamline data requirements often get bogged down by definitional issues and difficulties associated with modifying aged systems. **Elaborate policies and procedures, many of which are outdated but remain “on the books,” complicate the elimination and/or changing of requirements or processes. Attempts at standardization of data elements and standard general ledger postings often are met with differing accounting interpretations.**

#### **Issue 4 – “Convoluting” business processes which fail to streamline excessive process steps – sometimes driven by accounting, operational, and organizational structures, further complicated by aged and disparate systems**

The DoD is currently supported by a financial infrastructure that is not fully integrated in its end-to-end processing either from a technology perspective or from a functional process perspective. (See *Appendix A, Current Situation Examples*, for an example of a DoD Service travel process, which is one example of the complexities of processes.) Current processes are supported by multiple systems at various stages of technological innovation. **Many processes are duplicated due to non-interfaced systems along the business process chain, often requiring new input of data by hand, thereby increasing the probability for input errors and errors created by a lack of overall process knowledge.** Coordination of process hand-offs and shared process steps are specific targets for process congruence and functional and technological improvement. **Budget and appropriation systems are the primary driver for the vast majority of DoD's present financial system users. These systems add complexity but, more importantly, preclude, in many cases, the use of commercial off-the-shelf software (COTS) systems, without a reworking of the process.** In contrast, modern enterprise systems are developed to facilitate end-to-end seamless processing.

Attempts to charge the Services for overhead expenses (i.e., Working Capital Fund and reimbursables), while directionally correct, suffer from bad data and, as a result, add complexity that exceeds benefit. Differing practices by the Military Services (and difficulty in streamlining because of stovepipes, cultural issues, and funding streams) represent roadblocks to standardization. Much of the DoD information technology manpower is dedicated to “crosswalking” different inputs. **When reporting requirements change, new data fields must be developed at the various relevant sources, and new interface crosswalks laboriously developed among systems.**

Many requirements have accumulated over the years from congressional mandates without sunset. **One of the first priorities in the transformation process should be to identify requirements that could be streamlined or eliminated.**

#### **Issue 5 – Changing federal financial management standards that have provided a moving target for compliance**

Since the CFO Act of 1990, financial standards (new guiding principles) have been in a state of flux [Federal Accounting Standards Advisory Board (FASAB) Statements of

Federal Financial Accounting Standards (SFAS), OMB Form and Content, etc.] as the Federal government moved to the development of private sector-like financial statements. Implementation of a policy frequently has been dependent on the interpretation of the system owner at the DFAS and Service level. Often, system structure and processing constrain or limit correct implementation. Compounding the effect of a change is the multiple number of systems that need to be modified each time a standard is modified. Many of the changes to date have centered on the issues of Real Property and Property, Plant and Equipment –high priority areas for CFO compliance and a source of much resource investment by DoD within the past two years to solve this problem. However, some senior financial leaders note that the time and effort devoted to property values for financial statement purposes could be better spent elsewhere and that the CFO auditing policy should be made more relevant to the realities of the DoD environment.

All Federal agencies have faced this evolution of requirements. However, its impact across DoD where systems are disparate and cross-Service has made the moving target for compliance more problematic. (In *Appendix A, Current Situation Examples, Figure A-4* arrays these requirements of various legislation and pronouncements on a timeline as they have evolved from the enactment of CFO legislation to today.) Consideration should be given to working with the appropriate parties to enable a moratorium for DoD's attempting to meet certain selected standards, to better focus its efforts on actual forward progress.

**Issue 6 – Difficulty in obtaining financially based, outcome-oriented management metrics. Many metrics reflect yearly goals and outputs with little link between financial management and DoD goals.**

In 1999, the Under Secretary of Defense (Comptroller) [USD(C)] conducted a study of cost accounting capabilities. Certain challenges identified were: (1) DoD must decide what data element and program information it must collect in support of its Government Performance and Results Act (GPRA) performance measures; (2) DoD must decide how much autonomy the Services will have in implementing the strategy and how much will be directed; (3) DoD must decide on a scope and framework for the solution beyond regulatory reporting requirements; and (4) DoD must recognize that new data collection requirements may be necessary and that business process changes may result (within the cost benefit framework). These issues are yet unaddressed.

DoD uses a wide variety of metrics throughout the organization. The Department's current financial performance measurements generally reflect high-level yearly goals and outputs, not operational day-to-day financial managerial metrics. Amid a wide variety of published measurements throughout the Department, there is typically an inability to routinely generate cost-based metrics related to performance.

**Issue 7 – Inability to produce CFO compliant annual financial statements**

Audit reports issued by the Inspector General's staff highlight weaknesses in accounting records and processes required to achieve audited financial statements. **There is a need to review priorities for bridging the gaps in CFO Act audit compliance.** Several

interviewees even suggested a three or so year moratorium on attempting to obtain a clean opinion – using the associated dollars to address needed corrective actions rather than just generating numbers for the financial statements purposes alone.

An analysis of the FY 2000 audit reports, identifying the critical issues affecting the achievement of a clean audit opinion, is provided in *Appendix B, Recent Financial Management Audit Issues*. Most problems have been noted in prior year audit reports and are so overwhelming and the costs to fix them so large that the DoD, absent a financial management strategy, year after year finds itself moving from one priority to another – usually, to the one that received the most recent visibility.

**Issue 8 – Disproportionate budget dollars appear to support non-value added activities – since useful information is hard to extract, useful corrective action is hard to implement – with a lack of widespread understanding of how financial information can help**

Much debate has been generated around what percentages and dollar amounts should be concentrated in the operations and mission areas (sometimes referenced as "tooth") versus the support areas (referenced as "tail"). **But, proceeding down this “tooth-to-tail” semantic path has typically resulted in getting stuck in the quagmire of definitions. A better approach may be to target those functions where more efficient resource use could provide reallocations to operations and mission areas. For example, target functions that are “inherently commercial”, identify their costs, and compare and benchmark them against private sector data to determine what performance improvements need to be made.** Even in functions considered to be “tooth”, there may be low value added or redundant processes identified by more useful financial information, which would be candidates for reengineering.

**Issue 9 – Cultural bias toward status quo – driven by disincentives for change, and short timeframes of political appointees who otherwise might serve as agents of change**

The effect of the current budget rules – “use or lose” – creates an environment of disincentives for finding cheaper, faster ways of doing things. Reallocation of funds (money, people, programs and projects) under the control of the current users for investing in improvements is quite limited. Requirements to manage to the budget (established two years in advance) and the budget process cause managers to continuously be "out of sync" with current needs.

Many of the issues uncovered in our interviews and research have been dealt with effectively in private industry, largely because of the competitive forces of the marketplace and the focus on shareholder value. No similar external push exists within DoD. The Department needs change agents and drivers analogous to those agents and forces that have made the private sector competitive and efficient.

**Issue 10 – Requires an infusion of personnel with technical and financial skill sets necessary to achieve integrated financial management systems**

In the course of DoD's downsizing in recent years, longevity was often a major criterion for retention and not typically the private sector model of functional and performance value. As a result, new ideas, skill sets, and modernized ways of thinking are not sufficiently available to enhance DoD performance. Pay scales and reward packages available to technology workers, certified public accountants, and financial professionals in private industry have far outstripped the government's, thereby limiting the ability to attract and retain the required skills. As a result, many note that DoD has "lost a generation" of workers. This turnover is expected to continue over the next five years as nearly half of senior government executives are expected to retire in this timeframe. The choices are few, including raising pay scales to be competitive and/or engaging in substantial private sector partnering to deal with obvious skill set deficiencies.



## 4.0 Elements of Transformation

We believe that the absence of relevant, reliable and timely financial information (“financial intelligence”) and the need for an accelerated and a more assured pace in improving DoD efficiency can each be traced to similar origins within DoD’s operating fabric. **Accordingly, we recommend an integrated twin-track program to implement a financial transformation. It includes six broad elements that we believe are central to substantially improving the financial management within DoD and providing a foundation for change.** A lack of, or insufficient emphasis on, many of these elements perpetuates the current environment.

These Elements of Transformation are:

1. **Leadership** – establishing a SECDEF and senior leadership high priority for financial information transformation;
2. **Incentives** – addressing the current disincentives within DoD for engaging in financial reform;
3. **Accountability** – establishing a transformation framework with clear measurements, timeframes and assigned personal responsibilities and authority;
4. **Organizational Alignment** – SECDEF empowerment of the DoD Comptroller to act as the focal point for implementing an integrated DoD-wide program for financial management transformation;
5. **Changing Certain Rules** – directly addressing with Congress and OMB regulations and legal issues that hinder innovation and private sector partnering; and
6. **Changing Enterprise Practices** – modifying current overemphasis on Component process “uniqueness” that hinders forward progress, by standardization of core accounting requirements<sup>11</sup> and establishing a bias towards COTS systems.

### Leadership

***Working with Congress, OMB, GAO, and Others.*** We believe that the Secretary and the DoD Comptroller should begin now by presenting the financial management transformation framework, as a work in progress, to the appropriate congressional committees, GAO, OMB, and other key influencers. Much of what is needed cannot be accomplished without congressional understanding and assistance in implementing change. For example, elements of the human capital strategy, the CFO Act implementation plan, private sector partnering, budget reallocation transactions and related incentives, may require congressional approval or at least concurrence. If there are limits on their support in various areas, these should be addressed early in the program lifecycle.

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<sup>11</sup> Standardization of “core accounting” is intended to include only a subset of data required for DoD financial information management and does not include genuinely unique military data requirements. Typically, core requirements would include standard general ledger and related attributes and other data elements for recording accounting events at the transaction level and summarizing at correspondingly higher levels for financial management reporting.

***Generating the Change Management Strategy.*** The DoD must recognize that the initiatives outlined here require doing business in a way different from before. **This effort requires that the Department adopt change management strategies and a strategic communication approach that convey to the Department why this is important to the Secretary and DoD, how it will be implemented and measured, and the incentives to be utilized.** Many well-intended initiatives fail because of insufficient processes and communications to share objectives and purpose with the larger organization. The emphasis of messages may be different for different audiences but the themes must be consistent. SECDEF priorities must be clearly defined in these messages.

## **Incentives**

***Building Incentives for Information and Financial Management Transformation.*** In the current environment, position, prestige, influence, etc. are measured by traditional elements such as number of people managed, the size of the budget or the information controlled. In this scenario, there is little focus on major operational improvement and cost savings. **A new incentive system must be developed that encourages performance improvement and information management transformation, while rewarding efficiencies and cost savings.** This incentive system must address personnel issues in addition to allowing organizations to take advantage of cost savings by retaining some portion of the money saved for matters accorded a high priority by the SECDEF or the respective Service Secretary. The incentive system should also recognize top individual performance/promotions by the accomplishments or results achieved – not by the traditional view of managing to budget.

## **Accountability**

***Critical Success Factors.*** **Providing a framework to establish accountability begins with communicating SECDEF strategic goals and Critical Success Factors.** Critical Success Factors are "the 5-6 things that must go right" in the Secretary's view if DoD is to achieve its mission. In support of his Critical Success Factors, senior leadership under the SECDEF would then organize their own objectives. Establishing the SECDEF Critical Success Factors is key to initiating the "cascading effect" whereby his subordinates establish supporting objectives and related measurements.

***Developing Metrics.*** A set of financially based metrics needs to be developed to correspond with the SECDEF Critical Success Factors, goals and outcomes and the supporting objectives of his subordinates. Monitoring performance should happen through a forum of regular briefings given directly to the SECDEF leadership, utilizing a set of well-developed metrics to measure progress.

## **Organizational Alignment**

***Organizational Roles and Responsibilities.*** Information and financial management transformation require some changes in the organizational roles and responsibilities

**within DoD. To achieve this transformation, the responsible individual must exercise authority and be accountable.** The individual should have greater authority over budgets and requirements related to information and financial management in DoD. **Taking into account the OUSD(C) broadly-defined responsibilities in the Department, we believe that the Comptroller should be the responsible party with corresponding control of budgetary decisions and dollars affecting the improvement of financial management information.** The Comptroller should develop a strong relationship with the Assistant Secretary of Defense (Command, Control, Communications and Intelligence) [ASD(C3I)]. It is important to strengthen DoD's Chief Information Officer (CIO) capacities in systems planning, architecture and oversight.

Our interviews with senior leadership across the organization confirm a widespread desire for a clear vision and for someone to be in charge, to make the decisions necessary to achieve relevant and reliable data. Repeatedly, senior leadership across the organization notes that priorities must be established and then enforced—and the number of priorities must be manageable and funded (past history has shown that having 50+ priorities, which are not integrated, is not workable). These interviews also noted repeatedly that the current structure simply does not promote or support integration.

***Create a Human Capital Strategy.*** People with the necessary skill sets are absolutely critical to DoD's ability to achieve financial management transformation, and currently DoD does not have an adequate supply of such skill sets. Additionally, there is no comprehensive human resource strategy in place today to address this issue. In fact, most discussions of human capital or human resources focus on the attraction, development, and retention of internal staff. However, in the private sector as well as in more entrepreneurial government practices, leaders have recognized that effective human capital strategies include alternative sources of skills, including the use of private sector partnering, contracting, and shared service arrangements. They look at human capital strategy as including the full range of available people because they cannot afford to limit themselves to who they can hire and retain. **DoD must build a financial management human capital strategy that includes both internal and external elements.**

## **Changing Certain Rules**

***Streamline and Simplify.*** Current requirements for tracking funding and providing reports to various Federal entities (Congress, OMB, Treasury, etc.) place an **inordinate amount of complex information requirements on the DoD** that do not contribute to the performance of its mission. These complex requirements often drive impractical business processes and make it harder to align processes to private sector-like practices. Further complicating this requirement is the number of disparate systems operating in DoD that must be modified or maintained to track this information. Additionally, **many such requirements are self-imposed by DoD.** A focused effort aimed at eliminating self-imposed, non-value added requirements and working with regulatory agencies and Congress to simplify their requirements will ease the burden and shift the focus to more mission related information.

***Reallocating Dollars.*** We believe that proper categorization and costing can provide DoD managers across the Department with the financial information to manage resources more efficiently and, therefore, reallocate dollars where appropriate. Budgets that are developed two years in advance of activity allow only a limited amount of flexibility to adjust to changing requirements. Moreover, unreliable data often inhibits the justification of such reallocations. We are proposing a greater emphasis on having the management information necessary to make informed decisions regarding the reallocation of dollars and working with Congress and within DoD to change policies and procedures which inhibit such reallocations.

***Auditable Financial Statements – Getting the “Clean” Opinion for DoD.*** Given the current state of financial management operations, this is a long-term process. Full CFO Act compliance may take eight to ten years. A plan must be built based on a gap analysis – what has to be fixed to get a clean opinion. Working with the GAO, the DoD Inspector General and the Service audit agencies is critical. **The DoD should adopt the private sector model of teaming with the audit teams “year round” to resolve issues and not simply wait for the annual audit “test”.** The recent efforts in the area of Real Property valuation are a useful attempt that may serve as a model for coordination across DoD.

**A plan should be negotiated to provide for interim successes.** For example, we believe that the Statement of Budgetary Resources, with focus, could receive a clean audit opinion in a much shorter timeframe. It may also be possible for other Department Components to receive a clean opinion long before the whole agency. **Building intermediate success stories demonstrates progress and the Department’s willingness to meet the spirit of the CFO Act.**

## **Changing Enterprise Practices**

***Building Standards in Core Accounting and Attribute Data Elements.*** Standardization is the key to the interoperability of financial management and feeder systems. Standard data for "core accounting" elements enable systems to communicate with each other; also, they facilitate the auditing process when transactions must be traced from the general ledger to the originating accounting event and vice-versa. **The current systems plan, as articulated in the FMIP, often takes the path of least resistance by allowing the Services and Defense Agencies to keep their own “traditional” standards and, through the use of translation tools and systems interface programs, turn them into DoD standards.** Unfortunately, this approach encourages the continuation of old and potentially inefficient business practices and creates a very expensive systems maintenance problem down the road. **DoD must stop that practice and drive core accounting transaction standards from the new DoD Comptroller organization, described later, through the DFAS and the Services into all financial management and feeder systems.** According to the January 2001 FMIP, DoD is intending to invest at least \$4–6 billion in various financial management and feeder system initiatives. With occasional exception, DoD should stop the practice of investing in systems that do not incorporate standardization.

***Building a Bias toward Commercial-Off-the-Shelf (COTS) Software Solutions.*** The Department generally cannot afford to custom build and maintain new financial management systems. We agree that the DoD has many unique elements and process issues. However, we also believe that the reluctance to accept COTS is as much a reluctance to accept the inevitable business process changes that are mandated by this approach. **We see a double benefit here for the Department: first, cost savings through the implementation of best business practices imbedded in COTS products; and second, cost savings through less expensive and faster systems implementations.** The application of return on investment (ROI) analysis should also be adopted in all software implementation decisions.

***Driving Near-Term Improvements and Savings.*** While many components of the financial management transformation initiative will take years to accomplish, the Department cannot afford to wait that long to see tangible and dramatic cost improvements. **We believe that there are many opportunities to demonstrate the power of financial transformation without having to wait for auditable financial statements. There are tools and methods that will enable the DoD to implement process improvements and, possibly, reallocate dollars.**

Activity based costing (ABC) is one of the most widely accepted methods in use by both the private and public sector today. It provides the ability for an organization to understand what it costs to do what it does (e.g., repair F15 engines, provide accounting services to the Services, manage the logistics supply chain) and then make informed decisions of how and where to reduce costs. ABC is the front-end of a thoughtful, and relatively quick, assessment of an organization's operations. For example, the Naval Air Systems Command (NAVAIR) conducted a comprehensive ABC assessment that rolled directly into a business process reengineering solution, ultimately driving millions of dollars out of the organization cost structure over a relatively short period. ABC does have limits. For example, if organizational leadership is not supportive of the process and committed to delivering a streamlined operation as a result of the analysis, nothing will change.

Another target for potential savings and cost avoidance is in problem disbursements and the related areas of contract close-out. They have high visibility and may have prospects for near-term cost avoidance and savings, depending on the appropriate write-down or closure decisions driven by cost/benefit analysis. With leadership, much can change and DoD can use methodologies such as ABC and cost/benefit analysis comparisons to review more carefully its overhead structure and introduce process improvements.

It would also be useful to provide the Commanders in Chief (CINCs) and other "customers" with enhanced financial intelligence, analysis tools and incentives to better enable them to monitor and encourage the efficiency and effectiveness of their operations and suppliers.

## 5.0 Financial Transformation Framework

**A program is needed that will incorporate the elements described above** and provide for a functional and technical architecture for achieving integrated financial and accounting systems in order to generate relevant, reliable and timely financial information on a routine basis and, ultimately for obtaining a clean opinion. **The Study Group recommends a framework for a twin-track program for financial information transformation.** The recommended framework would not only take advantage of certain on-going improvement actions within the DoD but also provide specific direction for a more coordinated, managed, and results-oriented approach. The recommended framework includes:

### Twin Track Approach – High Level Overview

#### Track 1 – Structural Change

**Employ a coordinated DoD-wide management approach to developing standard integrated systems**, obtaining relevant, reliable and timely financial information (and ultimately a clean audit opinion) and aligning, incentivizing and authorizing the Department to utilize financial intelligence in an efficient and effective way.

**Structural Change (Track 1) will require a longer timeframe and will include establishing a centralized oversight process under the Comptroller for implementing the recommended structural changes and developing standard, integrated financial intelligence systems.** A phased approach should be taken which will allow for important yearly incremental success (e.g., with defined systems architecture and yearly incremental improvements).

#### Track 2 – Close-in Success

**Target, select and oversee implementation of a limited number of intra-Service/cross-Service projects for major cost savings or other high-value benefit under a process led by the Comptroller; assist the SECDEF in establishing and managing with a set of “Dashboard Metrics”.** Dashboard metrics should be derived from the SECDEF’s Critical Success Factors. **Track 2 should be used as a learning experience on using financial information to drive decision-making.**

Prime tools of such improvements would include ABC and benchmarking/best practices analysis to identify cost savings opportunities. A series of key management metrics will be identified, tracked and reported to those with senior managerial responsibility, including mission related-departments.

(During our interview process, logistics throughout DoD was mentioned numerous times as an area where progress has been made in recent years, but opportunities still exist for high-value improvements. While our timeframe did not allow us the opportunity to

analyze the costs and benefits of this particular reengineering prospect, it deserves active consideration by the proposed Management Initiatives Office described below.)

## **Twin Track Program Implementation**

**Critical to the success of both tracks of the recommended program is the establishment within the OUSD(C) of two new functions represented by distinct offices. Through these two offices – the Financial and Management Information Integration Office and the Management Initiatives Office – the Comptroller would provide executive control over processes, policies and resources for financial management and related systems transformation. Current structure does not provide for an authoritative focal point for DoD-wide financial management transformation.** Lean but full-time staffing is essential to the success of both offices. At the Comptroller's discretion, these two organizations could be staffed with newly recruited talent as well as existing DoD staff; they are intended to fill a void as discussed above, not to duplicate or create additional layers. These two offices would (working with the Components) develop options for approval, monitor progress and regularly report to the SECDEF on progress, problems, and possible solutions. They would control resources for financial management, systems transformation (although the Components would manage such programs), and take a leadership role in developing incentives. Each function must be headed by an individual who has sufficient stature and empowerment to act as an effective change agent. Led by the Comptroller, the heads of these two offices should reach out to the Services and DFAS, as well as Congress, to coordinate the development of a strategy and effective implementation. Each office is described below:

**Financial & Management Information Integration Office** – accountable for effective implementation and coordination of overall financial and related systems architecture [in consultation with the Services, the ASD(C3I) and others], systems integration, core accounting standardization and CFO compliance issues on an intra- and cross-Service basis; develop a phased plan for progressively increasing the number of individual statements on which a clean audit opinion can be obtained; and over time, institutionalize in DoD's financial management information systems the ability to routinely generate the Dashboard Metrics established by the Management Initiatives Offices and DoD senior leadership.

The major program components envisioned for this office are:

- Develop and “dictate” core accounting requirements (accounting transactions, Standard General Ledgers, attributes, and data elements) and manage a comparison ("gap analysis") to this core for each system slated to be part of the integrated network of CFO systems to determine funding priorities. Have the final decision-making authority for trade-offs and cost benefit decisions based on the gap analysis.
- **Develop a systems integration strategy and monitor on a regular basis in coordination with DFAS and the Services.** The strategy should consider both the needed integration for the development of core accounting and accurate financial statements as well as the requirements for managerial cost accounting.

- **Initiate a review to determine which burdensome rules/regulations should be eliminated or streamlined**, and a strategy to obtain necessary approval, identifying: (1) existing data elements that are no longer needed; and (2) reports that should be discontinued.

**Management Initiatives Office** – responsible for the process of establishing and initially reporting on Dashboard Metrics; and on an intra- and cross-Service basis, work with the DoD Components to select projects for major cost and operational improvements, providing initial funding for a limited number of projects per year and overseeing implementation with use of consultants and private sector partnering, as appropriate.

The major program components envisioned for this office are:

- Integrate Dashboard Metrics based on the SECDEF's Critical Success Factors into the management of DoD, monitor and regularly report on performance to SECDEF and senior leadership. Benchmark to similar private industry operations.
- Work with DoD Components to identify target areas for high-value cost savings and efficiency improvements, and entertain proposals from Components throughout DoD. A limited number of projects would be selected each year. Initial high target areas of opportunities should be projects for applying ABC or other process improvement initiatives.

The costs to initiate these two functions will include necessary funding for the salaries and related costs of the respective heads of the Financial & Management Information Integration Office and the Management Initiatives Office with full-time staff for each, as well as seed money to: (1) implement priorities for the Financial and Management Integration Office; (2) provide for selected cost savings projects within the Management Initiatives Office; and (3) hire consultants as necessary to perform specific tasks in support of the offices. Beyond the funding to initiate the two offices, we think that the transformation framework described herein will allow DoD to use the existing quantum of dollars spent on finance and accounting more efficiently.

**The path to full transformation is a long one. We recognize that the complete solution is key to ensuring that the transformation has a permanent impact on DoD operating policies; however, important nearer term improvements in operating efficiency and effectiveness can be achieved.**

**Contained in the tables on pages 19-24 is a high-level end-to-end financial management transformation strategy mapped to the elements of transformation described previously. Many of the elements require more granularity, which can only be developed at the discretion of the SECDEF, Comptroller, and other senior leadership.**



## Significant Challenges

We believe the most difficult challenges to be addressed in implementing our recommended program are:

- Developing an integrated system architecture including financial, accounting and feeder systems;
- Standardizing a DoD-wide “core” accounting and data classification;
- Engaging Congress and OMB to ameliorate certain rules: simplify record keeping and accounting requirements, remove impediments to a more efficient infrastructure management, and reduce hurdles to private sector partnering;
- Providing DoD management, including the CINCs, with enhanced financial intelligence, incentives and tools; and encouraging them to maximize the efficiencies and effectiveness of their operations and suppliers; and
- Imbuing the culture with a sense of urgency for a DoD-wide financial management information transformation, similar to Y2K.

## Catalyst for Change

The catalyst for effectively implementing these recommendations will be the leadership provided by Secretary Rumsfeld and his senior management team. A vision for financial information, such as that described herein, has been accomplished in the private sector on a widespread basis, through the development of financial intelligence and the reporting, analysis and measurement of business process reengineering results, using such intelligence. Our interviews and discussions with senior representatives of DoD, both current and past, lead us to believe that the organization is ripe for this financial management leadership change. The DoD needs good financial information if it is to follow Deputy Secretary of Defense Wolfowitz's admonition "to engage our brains before we open the taxpayer's wallet". This proposed transformation program will provide the needed leadership, accountability and structure to re-engineer financial management within DoD.

*“That which you require be reported on to you will improve, if you are selective. How you fashion your reporting system announces your priorities and sets the institution’s priorities.”*

Rumsfeld’s Rules

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Track 1 – Structural Change Recommended Implementation Actions		Responsibility
Leadership	SECDEF Leadership – one of SECDEF's and senior leaderships' highest priorities  Establish, empower and fund the Financial and Management Information Integration Office – reporting to USD(C)	SECDEF – Sr Leadership  SECDEF/OUSD(C)
Incentives	Create DoD-wide awareness and reward system in support of increased efficiency and improved productivity – money saver keeps a portion of savings within his/her organization for high value added purposes  Work (with Congress as required) to change the Personnel recognition and reward system to reinforce achievement in this financial information transformation initiative	SECDEF – Sr Leadership  SECDEF
Accountability	Institutionalizing in DoD's financial management information systems the ability to routinely generate the Dashboard metrics established by the Management Initiatives Office and DoD senior leadership	SECDEF – Sr Leadership; OUSD(C)



	Track 1 – Structural Change Recommended Implementation Actions	Responsibility
Changing Certain Rules	<p>Seek increased flexibility from Congress, OMB, Office of Personnel Management (OPM) and others to:</p> <ul style="list-style-type: none"> <li>▪ Reallocate and reinvest saved dollars</li> <li>▪ Remove outmoded impediments to a more efficient infrastructure               <ul style="list-style-type: none"> <li>– Simplify appropriations accounting requirements</li> <li>– Establish a cost-benefit analysis process for dealing with low value write-offs (e.g., unmatched disbursements below a minimum threshold, including elimination of accounting for cancelled accounts)</li> <li>– Consider "sunsetting" burdensome past mandates of reporting requirements</li> </ul> </li> <li>▪ Utilize more commercial practices in the process for private sector partnering</li> <li>▪ Negotiate a phased approach to achieving a clean audit opinion (e.g., can start with Statement of Budgetary Resources)</li> <li>▪ Seek authorization to break pay grades to hire and retain financial and technology talent (use IRS as example)</li> <li>▪ Personnel initiatives               <ul style="list-style-type: none"> <li>– Capitalize on looming large scale retirements as an opportunity to upgrade necessary skill sets</li> <li>– Enable DoD to match capabilities to needs rather than retention of staff by longevity (i.e., achieve rightsizing with the needed skill sets)</li> <li>– Establish personnel incentives related to achieving increased organization efficiency</li> </ul> </li> </ul>	SECDEF – Sr Leadership



Track 2 – Close-in Successes Recommended Implementation Actions		Responsibility
Leadership	SECDEF Leadership – one of SECDEF's and senior leaderships' highest priorities Establish, empower and fund the Management Initiatives Office – reporting to USD(C)	SECDEF – Sr Leadership SECDEF/OUUSD(C)
Incentives	Create DoD-wide awareness and reward system in support of increased efficiency and improved productivity – money saver keeps a portion of savings within his/her organization for high value added purposes Work (with Congress as required) to change the personnel recognition and reward system to reinforce importance of close-in actions	SECDEF – Sr Leadership SECDEF – Sr Leadership
Accountability	Identify and institutionalize SECDEF Critical Success Factors and Dashboard Metrics SECDEF's senior subordinates establish more granular Critical Success Factors and related metrics to achieve SECEF priorities Integrate metrics into the management of DoD, monitor and regularly report on performance to SECDEF and senior leadership Benchmark to similar private industry operations	SECDEF – Sr Leadership; SECDEF – Sr Leadership SECDEF – Sr Leadership OUUSD(C)

	Track 2 – Close-in Successes Recommended Implementation Actions	Responsibility
Organizational Alignment	<p>Emphasize Comptroller (CFO) leadership role in transformation program:</p> <ul style="list-style-type: none"> <li>▪ Use outside consultants as necessary</li> <li>▪ Provide regular briefings to SECDEF on progress, at least every 30 days</li> <li>▪ Provide initial funding for a limited number of projects each year</li> </ul>	SECDEF/OUUSD(C)
Changing Rules	Work with Congress and OMB to facilitate close-in cost and effectiveness improvement programs (e.g., enable more private sector partnering in processes that are inherently commercial)	SECDEF – Sr Leadership
Changing Enterprise Practices	<p>Develop and implement close-in major cost and efficiency improvement programs</p> <ul style="list-style-type: none"> <li>▪ Utilize cost management tools (e.g., Activity Based Costing and Management)</li> <li>▪ Select a limited set of intra-Service and cross-Service cost and/or process improvement targets of opportunity (e.g., consider DoD-wide logistics)</li> <li>▪ Benchmarking/best practices</li> <li>▪ Expand and continue successful efforts</li> </ul>	OUUSD(C)

# **Appendices**



## Appendix A. Current Situation Examples

Appendix A includes:

- Figure A-1: Recent Studies and Reports on DoD Financial Management
- Figure A-2: DoD Service Travel Disbursement Process – Before Revision
- Figure A-3: DoD Service Travel Disbursement Process – After Revision
- Figure A-4: Timeline of Federal Accounting Legislation and Pronouncements

### Figure A-1: Recent Studies and Reports on DoD Financial Management

In defining the current situation, we have drawn heavily on information gathered from prior reports and studies (see *Figure A-1* below). This information was supplemented through interviews of current and former DoD leaders.

Organization	Title	Date
Business Executives for National Security	Tail-to-Tooth Commission A Call to Action	(Not Dated)
Defense Science Board	More Capable Warfighting through Reduced Fuel Burden	January 2001
Defense Science Board	Achieving an Innovative Support Structure to Enhance Early 21 <sup>st</sup> Century Military Operations	November 1996
Defense Science Board	Outsourcing and Privatization	August 1996
General Accounting Office	DoD Financial Management: More Reliable Information Key to Assuring Accountability and Managing Defense Operations More Efficiently	April 14, 1999
General Accounting Office	Various Financial Management audit reports	1999-2000
Office of the Inspector General, DoD	Various Financial Management audit reports	1999-2001
Department of Defense	Financial Management Improvement Plan	January 2001

*Figure A-1: Recent Studies and Reports on DoD Financial Management*

### **Figures A-2 and A-3: Examples of "Convolutd" Business Processes**

These two charts depict a DoD Service travel process illustrated in before and after pictograms. As representative of convoluted and complex processes please note in the "Before" example, *Figure A-2*, the following: number of process steps; number of organizations involved; number of systems involved; and number of times the data must be re-keyed into a new system. As representative of how DoD does make positive strides toward streamlining (while further streamlining could occur), please note in the "Revised Process" pictogram, *Figure A-3*, the reduced number of process steps and the number of increased data that are edited - thereby reducing errors.

**Steps with dashes and \* denotes possible manual data entry.**

**Entities:** Traveler or Secretary, Command Activity, SATO - Local/SABRE, NAVPTO of SABRE, SATO HQ - Arlington, OPLC - Norfolk, Bank of America.

**Process Flow:**

- Traveler or Secretary makes request for travel (1a).
- Command Activity sends travel order (2a).
- Obligation data is transmitted to STARS (FL, HCM, WCF, etc.).
- SATO - Local/SABRE creates PNR in SABRE (4a) and makes travel reservation (4b).
- Traveler or Secretary sends travel order (5).
- NAVPTO of SABRE reviews travel order through visual check (6a) and matches travel order to SABRE record and approves (6b).
- NAVPTO of SABRE prints ticket for pick-up or forwards to traveler (7).
- SATO - Local/SABRE sends individual credit card transactions on a daily basis (10).
- SATO HQ - Arlington generates diskettes from reconciliation (16).
- SATO HQ - Arlington sends 2 diskettes of data (17).
- OPLC - Norfolk matches PTO bill to SATO HQ data and reformats data for STARS (18).
- OPLC - Norfolk transmits data (19).
- Local OPLCs query various financial systems (20).
- OPLC - Norfolk updates account with distribution (21b).
- OPLC - Norfolk transmits data (21a).
- Bank of America sends monthly hard copy invoice (9).
- Bank of America sends monthly credit card bill (11).
- NAVPTO of SABRE reconciles individual transactions to credit card bill (12).
- NAVPTO of SABRE notifies SATO HQ to produce final PTO Bill (15a).
- NAVPTO of SABRE sends final PTO Bill (15b).
- NAVPTO of SABRE reconciles Unmatched Summary Report (14).

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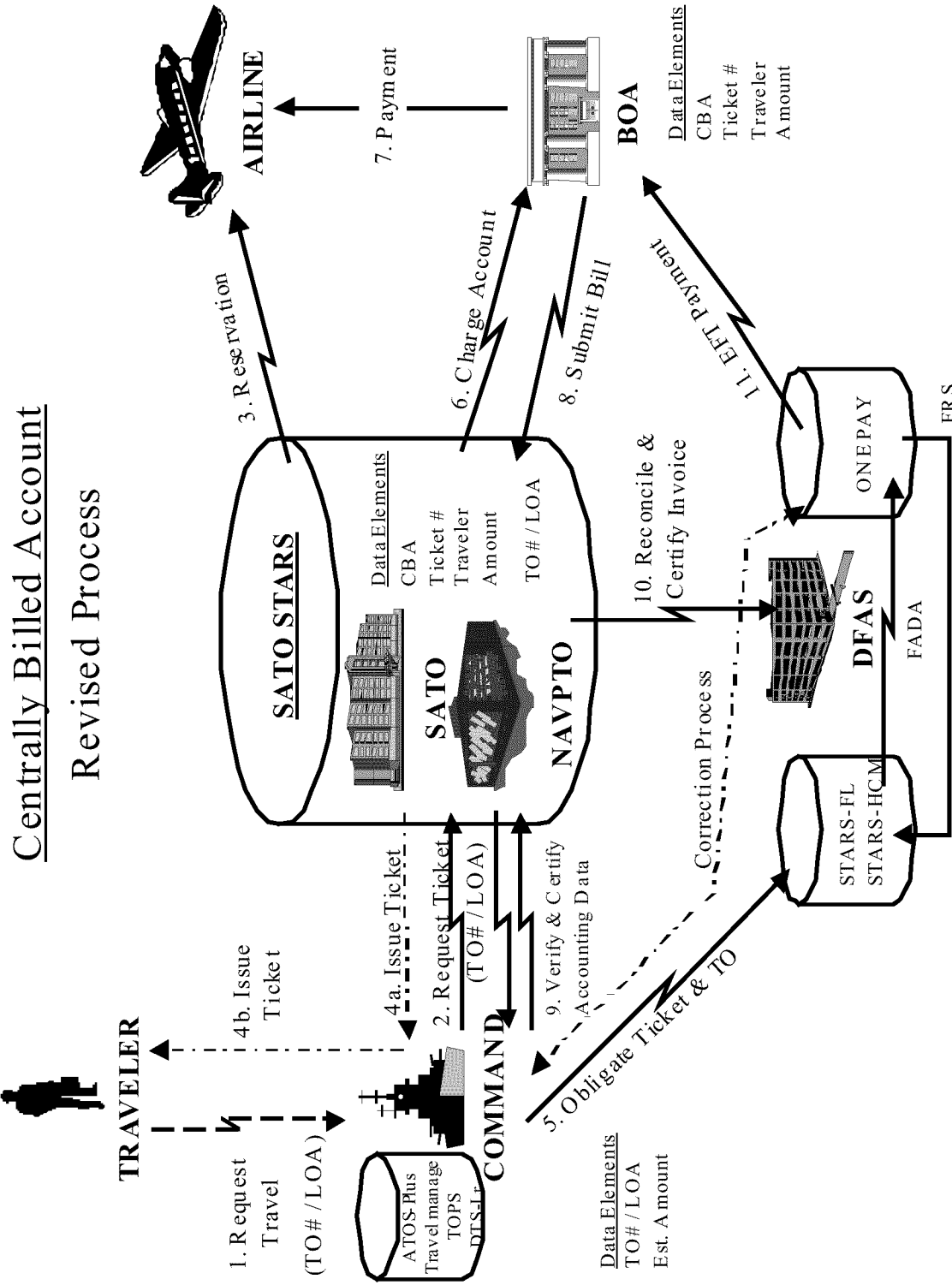
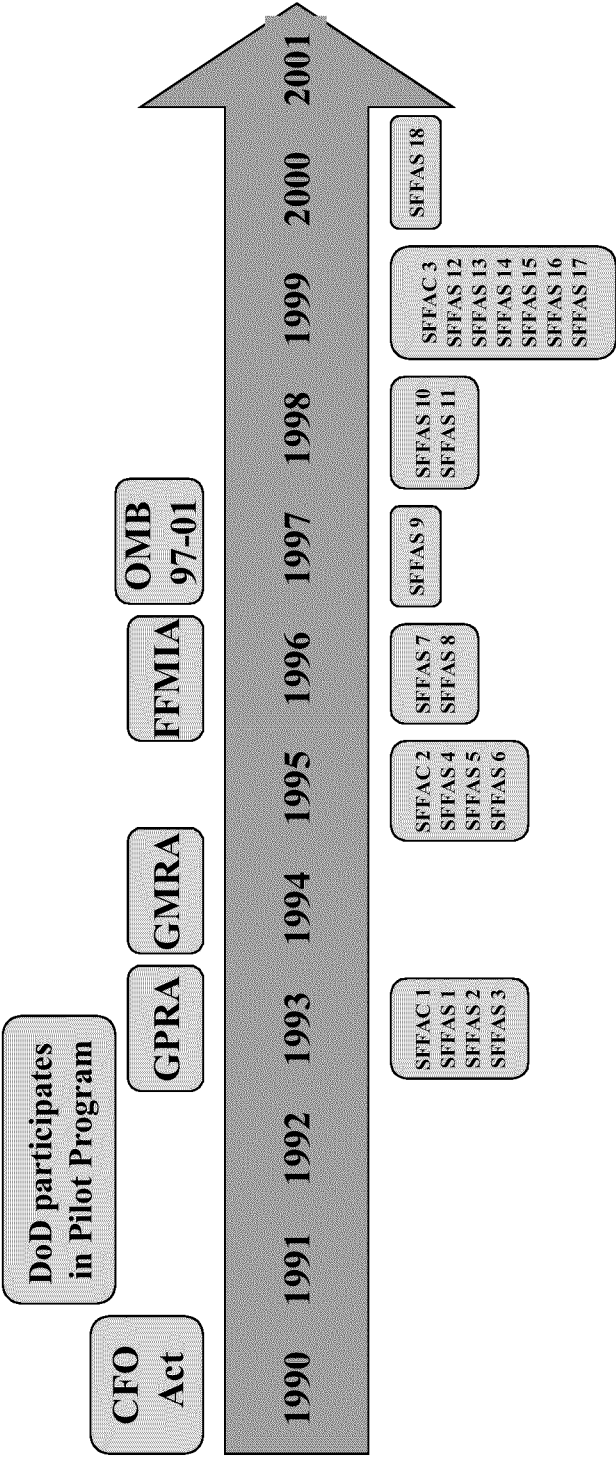


Figure A-3: DoD Service Travel Disbursement Process – After Revision

**Figure A-4: Timeline of Federal Accounting Legislation and Pronouncements**

Since the CFO Act of 1990, financial standards (new guiding principles) have been in a state of flux [Federal Accounting Standards Advisory Board (FASAB) Statements of Federal Financial Accounting Standards (SFFAS), OMB Form and Content, etc.] as the Federal government moved to the development of private sector-like financial statements. Below is a timeline of the legislation and pronouncements by issue date. The implementation date for many of the SFFASs follows the issue date by several years. Of the 18 SFFASs, ten had implementation dates of FY 1999 through FY 2001.



*Figure A-4: Timeline of Federal Accounting Legislation and Pronouncements*

- |  |  |
|--|--|
| CFO Act – Chief Financial Officers Act           | OMB 97-01 – Office of Management and Budget Form and Content |
| GPRA – Government Performance and Results Act    | SFFAC – Statement of Federal Financial Accounting Concept    |
| GMRA – Government Management and Results Act     | SFFAS – Statement of Federal Financial Accounting Standard   |
| FFMIA – Federal Financial Managers Integrity Act |  |

## Appendix B. Recent Financial Management Audit Issues

This appendix presents the findings noted in the audit reports without further clarification by DoD. Often, upon more careful review, one will find that confusion exists regarding the finding or that an issue has subsequently been addressed. A part of the financial management transformation strategy proposed in *Section 5.0, Financial Transformation Framework*, should be to establish priorities, based on defined criteria and an agreed-upon understanding of each issue.

Issue	Dollar Amount	Significance
<b>Plans to Improve Financial Management</b>		
<i>DoD lacks adequate financial management and feeder systems for compiling accurate and reliable financial data</i>		<p>Three major efforts to improve financial management:</p> <ul style="list-style-type: none"> <li>▪ DoD Financial Management Improvement Plan (FMIP)</li> <li>▪ DoD Critical Financial and Feeder Systems Compliance Process</li> <li>▪ DoD Implementation Strategies</li> </ul>
<i>DoD Guidance – Intragovernmental Eliminations</i>	<p>\$89.5 billion revenue/expense eliminations</p> <p>\$5.9 billion A/P and A/R eliminations</p> <p>\$1,200 billion</p>	<p>The inability of DoD to properly account for and disclose intragovernmental transactions and report trading partner eliminations is a major impediment to obtaining a favorable audit opinion on its financial statements. Since FY 1996, the Department has been slow to initiate improvements needed to ensure that all of the intragovernmental transactions were captured and the amounts were accurate.</p>
<i>Guidance Issued by DFAS</i>		<p>Journal Voucher Guidance issued by DFAS was not in agreement with generally accepted accounting principles. DFAS Centers processed 5,654 unsupported or improper department-level accounting entries, valued at \$1.2 trillion. One of the reasons that the department-level accounting entries were unsupported is that they were made to force general ledger data to agree with data from other sources without adequate research and reconciliation.</p>

Issue	Dollar Amount	Significance
<b>Overarching Financial Management Problems</b>		
<i>Changes to Financial Statements</i>		The published DoD Agency-Wide financial statements for FY 2000 differed materially from the financial statements presented for audit.
<i>Problem Disbursements</i>	\$4.4 billion	As of September 30, 2000, DoD reported \$1.7 billion of unmatched disbursements, \$1.2 billion of negative unliquidated obligations and \$1.5 billion (absolute value) of in-transit disbursements. The lack of integrated finance and accounting systems causes disbursing stations to make disbursements that were accounted for by stations that were not collocated with the disbursing stations.
<i>Basis for Accounting</i>		DoD generally records transactions on a budgetary basis and not on an accrual basis as required by accounting standards. This is particularly true of the accounting for the general funds, which generally record transactions on a cash basis.
<i>Inadequate Audit Trail</i>	<i>Supported entries</i> \$2,808 billion	The departmental-level accounting entries were processed to force financial data to agree with various data sources, to correct errors, and to add new data. Of the \$4.5 trillion, proper research, reconciliations, and adequate audit trails supported \$2.8 trillion of the department level accounting entries for FY 2000. DoD could improve the accuracy of its financial data by following accounting principles and including the proper support for any accounting entries made to the accounting records.
	<i>Unsupported entries</i> \$1,114 billion	
	<i>Improper entries</i> \$107 billion	
	<i>Entries not reviewed</i> \$477 billion	

Issue	Dollar Amount	Significance
<b>Balance Sheet</b>		
<i>Fund Balance With Treasury (FBWT)</i>	\$28.4 billion	The DoD Components and DFAS did not resolve financial and accounting disparities of \$28.4 billion, and the disparities continue to affect the accuracy of the FBWT account. Auditors were unable to assess the reliability of the \$177.5 billion reported for FBWT on the DoD Agency-Wide financial statements for FY 2000 (\$1.2 billion).
<i>Inventory and Related Property, including Operating Materials and Supplies</i>		DoD financial management systems were unable to accurately report amounts for inventory and related property on the DoD Agency-Wide financial statements for FY 2000. Internal controls over inventory were inadequate.
<i>General Property, Plant and Equipment (PP&amp;E)</i>	\$112.5 billion	Auditors were unable to verify the \$112.5 billion reported for DoD General PP&E because of a lack of supporting documentation. Previously identified problems still exist that affect the accuracy of amounts reported for real property.
<i>Military Retirement Health Benefits Liability</i>	\$192.4 billion	DoD continued to have problems with accurately reporting its Military Retirement Health Benefits Liability. The FY 2000 estimate of \$192.4 billion was based on unreliable data.
<i>Environmental Liabilities</i>	\$63.2 billion	For FY 2000, \$63.2 billion reported for DoD Environmental Liabilities could not be verified because of insufficient controls and inadequate audit trails. As a result, the Environmental Liabilities reported on the DoD Agency-Wide financial statements for FY 2000 were unreliable.



Issue	Dollar Amount	Significance
<b>Statement of Net Cost</b>		
<i>Program Cost Categories</i>		The program categories used for the DoD Agency-wide and DoD Components' Statements of Net Cost were not consistent with the DoD performance goals and measures outlined in the DoD Government Performance and Results Act of 1993 (GPRA) strategic and annual performance plans. DoD guidance incorrectly specified the use of appropriation categories, such as military personnel and operations and maintenance.
<b>Statement of Financing</b>		
<i>Agency-Wide</i>		DoD does not have the processes and financial systems in place to prepare a reliable Statement of Financing. The Statement of Financing reconciled \$454.1 billion of obligations reported on the Statement of Budgetary Resources with the \$347.5 billion net cost of operations reported on the Statement of Net Cost of the DoD Agency-Wide financial statements. However, this information was unreliable because DoD made adjustments to force budgetary and proprietary information to agree and did not disclose eliminating entries.
<b>Statement of Budgetary Resources</b>		
<i>Agency-Wide</i>		Auditors were unable to express an opinion on the Statement of Budgetary Resources because of deficiencies in internal controls and accounting systems related to the Statement of Budgetary Resources.

Issue	Dollar Amount	Significance
<b>Information Security/Internal Controls</b>		
<i>Agency-Wide</i>		<p>Security and application controls over financial management systems are critical to ensuring the integrity of data reported on the DoD Agency-Wide financial statements for FY 2000. DoD has become increasingly dependent on automated information systems to carry out its operations and to process, maintain, and report information in the annual financial statements. Auditors issued three reports and the General Accounting Office issued one report that identified security and application control weaknesses over systems that affected the amounts reported on the DoD Agency-Wide financial statements for FY 2000.</p>

## **Appendix C. Related Audit Reports and Testimony**

### **General Accounting Office**

GAO/T-AMID/NSIAD-00-264, Statement of Jeffrey C. Steinhoff, Assistant Comptroller General, before the Task Force on Defense and International Relations, House Committee on the Budget, "DoD: Implications of Financial Management Issues," July 20, 2000.

GAO/T-AMID/NSIAD-00-163, Statement of Jeffrey C. Steinhoff, Assistant Comptroller General, before the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform, "DoD: Progress in Financial Management Reform," May 9, 2000.

GAO/T-AIMD-00-137, Statement of David M. Walker, Comptroller General of the United States, before the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform, "Auditing the Nations Finances: Fiscal Year 1999 Results Continue to Highlight Major Issues Needing Resolution," March 31, 2000.

GAO/T-AIMD-99-131, Statement of David M. Walker, Comptroller General of the United States, before the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform, "Auditing the Nations Finances: Fiscal Year 1998 Results Highlight Major Issues Needing Resolution," March 31, 1999.

### **Office of the Inspector General, Department of Defense**

OIG, DoD, Report No. D-2001-070, "Internal Controls and Compliance with Laws and Regulations for the DoD Agency-wide Financial Statements for FY 2000," February 28, 2001.

Statement of Robert J. Lieberman, Assistant Inspector General for Auditing, DoD, before the Task Force on Defense and International Relations, House Committee on the Budget, "Department of Defense Financial Management", July 20, 2000.

OIG, DoD, Report No. D-2000-123, "Disclosure of Differences in Deposits, Interagency Transfers, and Checks Issued in the FY 1999 DoD Agency-wide Financial Statements," May 18, 2000.

Statement of Robert J. Lieberman, Assistant Inspector General for Auditing, DoD, before the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform, "DoD Financial Management," May 9, 2000.

OIG, DoD, Report No. D-2000-091, "Internal Controls and Compliance with Laws and Regulations for the DoD Agency-wide Financial Statements for FY 1999," February 25, 2000.

## **Appendix D. Individuals Interviewed During the Study**

### **Office of the Secretary of Defense**

Allen Beckett, Acting Under Secretary of Defense (Acquisition, Technology and Logistics)  
Karen Grosso, Attorney, Office of the General Counsel  
Dr. John Hamre, Former Deputy Secretary of Defense and Former Under Secretary of Defense (Comptroller)  
Doug Larsen, Deputy General Counsel  
Alice Maroni, Former Principal Deputy Under Secretary of Defense (Comptroller)  
Dr. David McNichol, Deputy Director, Resource Analysis, Program, Analysis and Evaluation  
Philip Odeen, Vice Chairman, Defense Science Board  
Roger Pitkin, Attorney, Office of the General Counsel  
Robert Soule, Director, Program Analysis and Evaluation  
Karen Yanello, Deputy General Counsel

### **Department of the Army**

Dave Borland, Vice Director, Information Systems for Command, Control, Communications and Computers/Deputy Chief Information Officer  
Ernie Gregory, Deputy Assistant Secretary of the Army (Financial Operations)  
GEN John Keane, Vice Chief of Staff of the Army  
Jan Menig, Deputy Assistant Chief of Staff for Installation Management

### **Department of the Navy**

Deborah Christie, Former Assistant Secretary of the Navy (Financial Management and Comptroller)  
Wes McNair, Director, Program/Budget Coordination Division, Office of the Assistant Secretary of the Navy (Financial Management and Comptroller)  
Dr. Bob Roarke, Comptroller, Naval Facilities Engineering Command  
Charlie Nemfakos, Senior Civilian Official, Office of the Assistant Secretary of the Navy (Financial Management and Comptroller)

### **Department of the Air Force**

Gen John Handy, Vice Chief of Staff of the Air Force  
Terry Keithley, Chief Financial Officer, Air Force Materiel Command  
Ron Orr, Assistant Deputy Chief of Staff for Installations and Logistics  
Earl Scott, Deputy Auditor General of the Air Force  
James Short, Associate Deputy Assistant Secretary (Financial Operations)

Ron Speer, Acting Assistant Secretary of the Air Force (Financial Management and Comptroller)

### **Defense Finance and Accounting Service**

Tom Bloom, Director, Defense Finance and Accounting Service

Audrey Davis, Director, Information and Technology

Joanne Kelley, Chief Field Assistant and Support Division, Accounting Directorate

Kathy Noe, Director for Systems Integration

Jack Nutter, Branch Chief, External Applications and DoD Initiatives Branch

### **Other Defense Agencies/DoD Field Activities**

Jay Lane, Director, Finance and Accounting, Office of the Inspector General, DoD

Robert Lieberman, Deputy Inspector General, DoD

David Steensma, Assistant Inspector General for Auditing, DoD

### **Congressional Committees**

Dionel Aviles, Professional Staff Member, House Committee on Armed Services

Larry Lanzillotta, Professional Staff Member, Senate Committee on Armed Services

Peter Levine, Professional Staff Member, Senate Committee on Armed Services

### **Other Federal Departments/Agencies**

Sean O'Keefe, Deputy Director, Office of Management and Budget, Nominee

### **Private Sector**

Gen (Retired) Richard Hearney, President, Chief Executive Officer, Business Executives  
for National Security

Arnold Punaro, SR VP Corporate Development, SAIC